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INSPECTOR GENERAL, DOD, OVERSIGHT
OF THE AUDIT OF THE FY 2000
MILITARY RETIREMENT FUND
FINANCIAL STATEMENTS

Report No. D-2001-068

February 28, 2001

Office of the Inspector General
Department of Defense

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Acronyms

DFAS
OMB

Defense Finance and Accounting Service
Office of Management and Budget



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

February 28, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
UNDER SECRETARY OF DEFENSE (PERSONNEL AND
AND READINESS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Audit of the
FY 2000 Military Retirement Fund Financial Statements
(Report No. D-2001-068)**

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the unqualified opinion expressed by Deloitte & Touche LLP on the FY 2000 Military Retirement Fund Financial Statements. It also includes the reports issued by Deloitte & Touche LLP: the "Independent Auditors' Report" and the "Independent Auditors' Report on Internal Control Over Financial Reporting and Compliance Based Upon the Audit Performed in Accordance With Government Auditing Standards." An audit of the FY 2000 Military Retirement Fund Financial Statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Because this report contains no findings or recommendations, written comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. David F. Vincent at (703) 604-9109 (DSN 664-9109) (dvincent@dodig.osd.mil) or Mr. Thomas J. Winter at (703) 604-9134 (DSN 664-9134) (twinter@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-068

(Project No. D2000FH-0233.000)

February 28, 2001

Inspector General, DoD, Oversight of the Audit of the FY 2000 Military Retirement Fund Financial Statements

Executive Summary

Introduction. Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD to prepare annual audited Military Retirement Fund Financial Statements. Office of Management and Budget (OMB) Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” October 16, 2000, establishes the minimum requirements for audits of these financial statements. This Bulletin requires the Inspector General, DoD, or an independent auditor, to express an opinion on the DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations. We contracted the audit of the FY 2000 Military Retirement Fund Financial Statements to Deloitte & Touche LLP, an independent certified public accounting firm. This report discusses the work we performed on the oversight of the audit of the FY 2000 Military Retirement Fund Financial Statements.

Objective. Our objectives were to oversee the Deloitte & Touche LLP audit of the FY 2000 Military Retirement Fund Financial Statements and to determine the reliability and effectiveness of processes and procedures used to prepare those statements. See Appendix A for a discussion of the audit process.

Unqualified Opinion. Deloitte & Touche LLP expressed an unqualified opinion on the FY 2000 Military Retirement Fund Financial Statements. We concur with the Deloitte & Touche LLP unqualified opinion; our endorsement of that unqualified opinion is Exhibit 1. The Deloitte & Touche LLP “Independent Auditors’ Report” is Exhibit 2.

Internal Controls. Deloitte & Touche LLP considered the Military Retirement Fund internal controls when determining the audit procedures for the purpose of expressing an opinion on the financial statements. The Deloitte & Touche LLP report, “Independent Auditors’ Report on Internal Control Over Financial Reporting and Compliance Based Upon the Audit Performed in Accordance With Government Auditing Standards,” is Exhibit 3.

Deloitte & Touche LLP did not detect any material internal control weaknesses during the audit that would be considered a reportable condition. A reportable condition would be a significant deficiency in the design or operation of the internal controls that

would cause a material misstatement in the financial data. However, Deloitte & Touche LLP did identify the non-material conditions described in the following paragraph.

The general electronic data processing controls at the computer processing locations used by the Military Retirement Fund do not provide reasonable assurance that logical security tools and techniques have been implemented, configured, and administered to restrict access to programs, data, and other information resources. Control weaknesses included deficiencies in the design and operation of electronic data processing access controls, security policies and procedures, and program change controls that could adversely affect the Military Retirement Fund's ability to record, process, and summarize its financial information in accordance with all appropriate requirements. This report does not include details because disclosure of detailed information about security weaknesses may further compromise controls. Details will be presented in a separate management letter with limited distribution in accordance with Government Auditing Standards.

Compliance With Laws and Regulations. Deloitte & Touche LLP reviewed the Military Retirement Fund for compliance with laws and regulations in order to obtain reasonable assurance about whether the financial statements were free of material misstatements. The Deloitte & Touche LLP review was in accordance with Government Auditing Standards, OMB Bulletin No. 01-02, and OMB Circular No. A-127, "Financial Management Systems," as revised July 23, 1993. The Circular requires that Federal financial systems provide complete, reliable, consistent, and useful information on a timely basis. Deloitte & Touche LLP identified instances of noncompliance that are described below.

- The electronic data processing systems utilized by the Military Retirement Fund are not fully compliant with OMB Circular A-127. Deloitte & Touche LLP identified design and operation deficiencies that could compromise the ability to provide reliable data.
- Although the general ledger system used by the Military Retirement Fund is compliant with the U.S. Government Standard General Ledger, it is not transaction-based or derived from an integrated financial system. Additionally, the general ledger has two feeder systems that are not fully compliant with the U.S. Government Standard General Ledger.

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Appendix A. Audit Process

Background

Introduction. Legislation requires financial statement audits by the Inspectors General and prescribes the responsibility of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. Management is responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to DoD financial accounting and reporting. Our responsibility is to render an opinion on the financial statements, and to determine whether internal controls are adequate and whether the entity complied with laws and regulations.

Accounting Principles. The Military Retirement Fund (the Fund) Financial Statements were to be prepared in accordance with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. Footnote 1 of the Fund Financial Statements, discusses the significant accounting policies used in preparing the financial statements.

Federal Accounting Standards Advisory Board Standards. The Federal Accounting Standards Advisory Board was established by OMB, the U.S. Department of the Treasury, and the General Accounting Office. On October 19, 1999, the American Institute of Certified Public Accountants recognized the Federal Accounting Standards Advisory Board as the body to establish generally accepted accounting principles for Federal government entities. Therefore, Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board are recognized as generally accepted accounting principles for applicable Federal government entities.

Fund Administration. In April 1995, the Defense Finance and Accounting Service (DFAS) consolidated the military retiree and annuity pay systems and operations into the Defense Retiree and Annuitant Pay System at DFAS Cleveland, Cleveland, Ohio, and DFAS Denver, Denver, Colorado. DFAS Cleveland establishes and maintains retiree accounts, and DFAS Denver establishes and maintains survivor annuitant accounts. The Defense Retiree and Annuitant Pay System is the standard DoD system that gathers, stores, and processes data required to generate and account for payroll for all DoD military retirees, former spouses of these retirees, and survivor benefit plan annuitants. The DoD Office of the Actuary determines the funding requirements for the Military Retirement Fund. Based on those requirements, the Investment Trust Fund Directorate, Accounting Deputate, DFAS, monitors the contributions that the Military Departments and the U.S. Treasury make to the Fund and invests those contributions in market-based U.S. securities.

Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the “Chief Financial Officers Act of 1990,” as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” and OMB Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, we performed oversight of the independent audit conducted by Deloitte & Touche LLP of the Fund Financial Statements. We reviewed the Deloitte & Touche LLP audit approach and monitored audit progress at key points.

Reviewing the Deloitte & Touche LLP Audit Approach. We used the “Financial Audit Manual,” December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the Deloitte & Touche LLP audit approach. Specifically, we reviewed the audit plans, programs, and working papers, supported Deloitte & Touche LLP audit efforts, and participated in conferences held during the audit.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures.

FY 2001 DoD Corporate-Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**

FY 2001 Subordinate Performance Goal 2.5: Improve DoD financial and information management. **(01-DoD-2.5).**

FY 2001 Performance Measure 2.5.2: Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2).**

DoD Functional Area Reform Objectives and Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Area. Objective: Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers’ Financial Integrity Act of 1982. **(FM-5.3).**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Audit Type, Period, and Standards. We performed this financial statement audit from June 26, 2000, through February 7, 2001, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data to conduct our oversight of the Deloitte & Touche LLP audit of the Fund Financial Statements.

Contacts During the Audit. We visited or contacted individuals and organizations in the DoD audit community. Further details are available on request.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Personnel and Readiness)
Deputy Under Secretary of Defense (Program Integration)
Director, Defense Manpower Data Center
Chief Actuary, DoD Office of the Actuary

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
General Accounting Office
Deloitte and Touche LLP

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and
International Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International
Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on
Government Reform

**Exhibit 1. Inspector General, DoD,
Endorsement Memorandum**



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

February 1, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
UNDER SECRETARY OF DEFENSE (PERSONNEL AND
READINESS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Endorsement of the Unqualified Opinion on the FY 2000 Military
Retirement Fund Financial Statements (Project No. D2000FH-0233.000)**

In accordance with the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Fund (MRF) Financial Statements. For FY 2000, we contracted with Deloitte & Touche LLP to audit the MRF Financial Statements. Deloitte & Touche LLP is an independent certified public accounting (CPA) firm that was competitively selected for this audit by the IG, DoD.

Unqualified Audit Opinion. We concur with the Deloitte & Touche LLP unqualified opinion dated February 1, 2001, that the FY 2000 MRF Financial Statements and accompanying notes present fairly, in all material respects, the MRF financial position as of September 30, 2000, and its net cost, changes in net position, budgetary resources, and reconciliation of budgetary resources to net cost for the year then ended. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America.

We concur with the Deloitte & Touche LLP report on internal controls over financial reporting in connection with the audit of the FY 2000 MRF Financial Statements, which stated:

A certain matter involving the internal controls over financial reporting was considered to be a reportable condition. Specifically, the general electronic data processing (EDP) controls at the computer processing locations used by the MRF do not provide reasonable assurance that logical security tools and techniques have been implemented, configured, and administered to restrict access to programs, data, and other information resources. Although a reportable condition, Deloitte & Touche LLP believed that the reportable condition was not a material weakness.

As part of obtaining reasonable assurance about whether the MRF financial statements are free of material misstatement, tests were performed of the MRF's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000. The results

of these tests performed by Deloitte & Touche LLP disclosed instances of noncompliance that are required to be reported. Specifically, the noncompliance concerns are the following.

- EDP systems utilized by the MRF that are not fully compliant with OMB Circular A-127, "Financial Management Systems."
- The general ledger system utilized by the MRF is not transaction based or derived from an integrated financial system.

Audit Responsibilities. We are responsible for obtaining reasonable assurance about whether the Principal Statements are fairly presented and free of material misstatement, in conformity with accounting principles generally accepted in the United States of America.

To help fulfill these responsibilities, we contracted with Deloitte & Touche LLP to perform the financial statement audit in accordance with generally accepted Government auditing standards; OMB Bulletin No. 01-02; and the GAO "Financial Audit Manual," December, 1997. The IG, DoD, evaluated the nature, timing, and extent of the work, monitored progress throughout the audit, reviewed the working papers of the CPA firm, met with partners and staff members, evaluated the key judgments, met with officials of the MRF, performed independent tests of the accounting records, and performed other procedures appropriate in the circumstances.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

**Exhibit 2. Deloitte & Touche LLP Opinion
Report, “Independent Auditors’
Report”**



INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
Department of Defense

We have audited the accompanying balance sheets of the Department of Defense (DoD) Military Retirement Fund (the Fund) as of September 30, 2000 and 1999, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the management of the Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD Military Retirement Fund as of September 30, 2000 and 1999, and its net cost, changes in net position, budgetary resources and reconciliation of budgetary obligations to net cost for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying required supplementary information is not a required part of the basic financial statements but is supplementary information required by the OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. The other accompanying information on actuarial status at Table I is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such supplementary and other information have been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

To the Inspector General of the
Department of Defense
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In accordance with *Government Auditing Standards*, we have also issued our report dated February 1, 2001 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

February 1, 2001

**Exhibit 3. Deloitte & Touche LLP Report,
“Independent Auditors’ Report on
Internal Control Over Financial
Reporting and Compliance Based
Upon the Audit Performed in
Accordance With Government
Auditing Standards”**



INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Inspector General of the
Department of Defense

We have audited the financial statements of the Department of Defense (DoD) Military Retirement Fund (the Fund) as of and for the year ended September 30, 2000, and have issued our report thereon dated February 1, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described below is not a material weakness.

1. The general electronic data processing (EDP) controls at the computer processing locations used by the Fund do not provide reasonable assurance that logical security tools and techniques have been implemented, configured, and administered to restrict access to programs, data, and other information resources. Our review disclosed deficiencies in the design and operation of EDP access controls, security policies and procedures, and program change controls that could adversely affect the Fund's ability to record, process,

and summarize its financial information in accordance with all appropriate requirements. Because disclosure of detailed information about security weaknesses may further compromise controls, we are providing no further details here. Instead the specifics will be presented in a separate, limited distribution management letter.

Compliance

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 01-02. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and that are described below.

1. The EDP systems utilized by the Fund are not fully compliant with OMB Circular A-127, *Financial Management Systems*. The Circular requires that federal financial systems provide complete, reliable, consistent and useful information on a timely basis. Our procedures identified deficiencies in the design and operation of EDP controls that increase the risk of unauthorized access to and modification of sensitive data. This condition compromises the ability of the systems to provide reliable data.
2. While the general ledger system utilized by the Fund is compliant with the United States Standard General Ledger (SGL), it is not transaction based or derived from an integrated financial system. Additionally, the general ledger has two "feeder" systems that are not fully compliant with the SGL.

Distribution

This report is intended solely for the information and use of the Inspector General of the Department of Defense, management of the Fund, other Defense Organizations, the Office of Management and Budget, the General Accounting Office, and the United States Congress and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

February 1, 2001

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

F. Jay Lane
Salvatore D. Guli
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Thomas J. Winter
Lisa Y. Johnson
Fred R. McComas
Alberto T. Rodriguez